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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1955

No. 695

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
Petitioner,

v.

THE UNITED STATES,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

JAMES K. POLK,
Counsel for Petitioner,
40 Wall Street,
New York 5, N. Y.

Of Counsel:
ROBERT E. COULSON,
HAROLD F. NONEMAN.

INDEX

	PAGE
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	6
Conclusion	13
Appendix A—Statutes	15
B—Opinion below	17
—Findings of fact below	25
—Conclusion of law and judgment below	44

CITATIONS

CASES:

Chestnut Securities Co. v. *United States*, 104 C. Cls. 489 ..... 11, 12

Commissioner v. *Boylston Market Ass'n.*, 131 F. 2d 966 7

Cooperstown Corporation v. *Commissioner*, 144 F. 2d 693, *cert. denied*, 323 U. S. 772 7

Dixie Pine Products Co. v. *Commissioner*, 320 U. S. 516 ..... 6, 8, 12

PAGE

Lewyt Corporation v. *Commissioner*, 349 U. S. 237 ..... 6, 8, 9, 12
Lucas v. *American Code Co.*, 280 U. S. 445 ..... 12, 13

People ex rel. Wessel, Nickel & Gross v. *Craig*, 236 N. Y. 100 7

Security Flour Mills Co. v. *Commissioner*, 321 U. S. 281 ..... 6, 7, 8, 12

United States v. *Anderson*, 269 U. S. 422 ..... 9, 12
United States v. *Olympic Radio & Television Inc.*, 349 U. S. 232 ..... 6, 8, 10

STATUTES:

Internal Revenue Code of 1939:

Sec. 23(c) (26 U. S. C. 1946 ed., Sec. 23(c)) 2, 4, 5, 6, 7, 8, 9

Sec. 41 (26 U. S. C. 1946 ed., Sec. 41) 9

Sec. 43 (26 U. S. C. 1946 ed., Sec. 43) 9

Sec. 48 (26 U. S. C. 1946 ed., Sec. 48) 9

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Consolidated Edison Company of New York, Inc. prays that a writ of certiorari issue to review the judgment of the United States Court of Claims, entered in the above entitled case on December 6, 1955.

Citation to Opinion Below

The opinion of the Court of Claims, printed in Appendix B, infra, pp. 17-25,[1] is reported in 135 F. Supp. 881, but not yet in the Court of Claims reporter.

Jurisdiction

The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255(1).

[1] All page references, unless otherwise indicated, are to this petition.

Question Presented

Whether under Section 23(c) of the Internal Revenue Code of 1939 a contested real estate tax liability accrues in the year the litigation is ended or, prior thereto, in the year the disputed tax is involuntarily paid.

Statutes Involved

The applicable provisions of the pertinent statutes are set forth in Appendix A, infra, pp. 15-16.

Statement

Petitioner sells electricity and gas in the New York area (finding 1, p. 25) and owns numerous parcels of real estate devoted to its business as a gas and electric utility (finding 5, p. 26). It kept its books and filed its income tax returns on the accrual basis (finding 2, p. 25). The taxable years involved are 1938, 1939 and 1941.

As above stated the question presented in this case involves the determination of the year in which deductions should be taken in respect to the local real estate taxes on these parcels which were contested and unadmitted.

The facts may be conveniently stated by using, instead of actual figures, a hypothetical real estate assessment of $100 for 1939. The parties and the court below adopted this method of concisely stating the issue involved (finding 42, p. 41).

On January 25, 1939 petitioner was notified of a tentative assessment of $100 (in terms of the illustrative example) on its New York City real estate (findings 6, 42, pp. 27, 41). By March 15, 1939 petitioner filed with the New York tax authorities a bona fide protest against this assess-

ment; in this protest petitioner admitted liability of $85 but petitioned for administrative reduction of the assessment by $15 (finding 42, p. 41). The valuation claimed in the protest was based on the best judgment of petitioner's officers and of independent experts (findings 21, 22, 42, pp. 34, 41).

On May 25, 1939, after a hearing, a final assessment of $100 was made (finding 42, p. 41).

Under New York law the institution of a court proceeding to correct an assessment does not postpone the due date of the tax, and failure to pay on the due date subjects the real estate to a lien which can be foreclosed and the property sold (finding 13, p. 30). Accordingly on October 1, 1939, petitioner, under protest and reserving its rights, paid the $100 in order to avoid liens, seizures, levies, penalties, and interest (findings 17, 42, pp. 32, 41).

On October 25, 1939, petitioner instituted proceedings in the appropriate New York State Court to expunge the excessive portion of the assessment; in its petition to review petitioner again admitted liability of $85 but denied liability for the $15 by which the assessment exceeded $85 (findings 18, 20, 42, pp. 33, 41). Petitioner was confident that the valuation it claimed would ultimately be sustained by the court (findings 21, 24, p. 34).

Thereafter, the New York court proceedings were compromised, and on August 21, 1941 an order was entered in those proceedings fixing petitioner's tax for 1939 at $95 (findings 23, 28, 42, pp. 34, 35, 41). In October, 1941 petitioner received back from the New York tax authorities $5 of the originally disputed $15 (finding 42, p. 41).

Decision of Commissioner of Internal Revenue

The Commissioner of Internal Revenue allowed as deductions for "taxes paid or accrued" in 1939 the amounts ultimately determined in 1941 to have been proper ($95)—

and at the same time included in petitioner's gross income for 1941 the refunded overpayments ($5) of the 1939 real estate taxes.

Petitioner's Contention

The petitioner claims that the amount of taxes accrued within a taxable year must be determined in accord with the normal accounting concepts relevant to the accrual basis.

On the basis of the undisputed proofs of record, the Court below found that under recognized accounting principles on the accrual basis, no expense deduction may be had for a liability which is denied (finding 38, p. 39); this principle is equally applicable to disputed local taxes (finding 38, p. 39); the basic concept of accrual accounting is that the flow of cash has no effect upon income or expense determination (finding 36, p. 39); payment of a liability that is denied does not "accrue" it (findings 37, 38, p. 39); and payment of an unadmitted and still contested amount is recorded as an asset in the nature of a deposit or prepayment and not as an income or expense determining transaction (finding 38, p. 39). The Court further found as a fact that under these generally accepted and well recognized principles of accrual accounting the disputed $15 which was paid in 1939 constituted an asset until 1941 when the asset was reduced to $5 (finding 45, p. 42); and that $10 accrued and was deductible as an expense in 1941, and was not to be related back to 1939 (finding 46, p. 42).

Petitioner therefore claims that under Section 23(c), which provides for the deduction of "taxes paid or accrued within the taxable year", the proper amounts deductible in 1939 on the accrual basis were the portions of the assessed taxes admitted by petitioner to have been proper ($85); that of the unadmitted and contested portions ($15) the additional amounts ultimately determined in 1941 to have been proper ($10) were deductible in 1941; and the refund in 1941 of the overpayments ($5) did not constitute income

but an exchange of assets—an exchange of "deposit for contested taxes" for "cash."

Decision of the Court Below

The Court below held* that the *payment* of a disputed tax accrues the tax; therefore the entire amount of the assessed tax ($100), including that which was denied and actively contested in the New York courts ($15), accrued and was deductible under Section 23(c), in 1939; and that the refund of the excess payment ($5) in 1941 upon the termination of the litigation was income to petitioner in that year. In reaching this decision the Court acknowledged that a taxpayer may not accrue taxes for purposes of federal income tax deduction during a year in which he is contesting the taxes and has not paid them over to the tax collector, and that, under generally accepted accounting principles, payment of contested taxes to the tax collector under protest does not make it proper to accrue such taxes. It necessarily followed, therefore, that, if tax consequences were to harmonize with accounting principles, only $85 of the 1939 real estate tax assessment of $100 could be regarded as accrued for purposes of income tax deduction in 1939, even though petitioner actually paid $100 to the New York tax authorities in that year, and that no part of the contested $15 could be deemed accrued as a deduction in 1939. The Court below avoided reaching this conclusion by summarily rejecting the application of generally accepted accounting principles "because such principles represent a refinement in ascertaining net income that would be impractical and, in our opinion, infeasible in the administration of the revenue laws" (Appendix B, p. 24). Having rejected *accepted* accounting principles, the Court followed its own doctrine that payment of contested taxes, even though involuntary, under protest and with the most sincere belief that a refund will be forthcoming, nevertheless accrues them in the full amount of the payment as a deduction in the year in which the payment is made.

* Jurisdiction was based on 28 U. S. C., Section 1491.

Summarizing the foregoing, the Commissioner allowed a $95 deduction for 1939 and taxed $5 in 1941; the court below allowed a $100 deduction in 1939 and taxed $5 in 1941; and the petitioner claims $85 is allowable as a deduction in 1939, $10 is allowable as a deduction in 1941, and the receipt back of the $5 deposit is not income in any year.

Reasons for Granting Writ

1. The decision of the Court below is contrary to the principles of accrual and contrary to the method of determining the amount of such accrual established by this Court in *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516 (1944); *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281 (1944); *United States* v. *Olympic Radio and Television, Inc.*, 349 U. S. 232 (1955); and *Lewyt Corporation* v. *Commissioner*, 349 U. S. 237, 242-243 (1955).

(a) The *Dixie Pine* and *Security Flour Mills* cases clearly establish that an accrual basis taxpayer may not accrue and deduct a tax liability which is denied and contested until the year in which the litigation is ended.

Dixie Pine held that the denial and contest of the State tax liability made that liability "contingent," rather than "fixed and certain," even though the State statute imposed upon the taxpayer a definite, fixed and certain obligation to pay the disputed tax; and that, therefore, the disputed tax liability did not accrue and become deductible, under Section 23(c), in a year prior to the year in which the litigation terminated (320 U. S. 516, 519).

The Court below, however, held that the contested real estate tax liability did accrue and become deductible before the litigation ended because of its payment, "even though payment is made under protest and even though litigation

is started within the taxable year to obtain repayment." (p. 24). But an involuntary payment[2] of a contested tax liability makes that liability no less contingent nor more fixed and certain, for purposes of accrual and deduction under Section 23(c), than does the statutory obligation to pay the tax—the outcome of the litigation must still be awaited to fix and determine the extent and amount of the contested tax liability.

It is not merely the payment of an item, but rather the nature or character of the item paid, that determines its accruability or deductibility.[3] Admittedly, the contested tax liability was not accruable or deductible a moment before it was paid. There is nothing in any concept of accrual which transforms a non-deductible item into a deductible one by an involuntary payment. Payment under such circumstances simply creates another capital asset—a deposit for contested taxes—to take the place of the cash turned over to the local tax authorities (finding 38, p. 39).[4]

The situation in the instant case is, for all practical purposes and in economic reality, not unlike that in *Security Flour Mills* where the taxpayer, under Court order, paid the disputed tax to a bank designated by the Court. The flour mill was as much out-of-pocket the amount of the disputed taxes paid to the bank under the Court order as was petitioner when it involuntarily paid the disputed tax to the City of New York. In both instances the payment was made subject to repayment depending upon the outcome of the litigation; and in both instances the liability for the disputed tax remained contingent and uncertain until the litigation was terminated.

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[2] See *People ex rel. Wessel, Michel & Gross* v. *Craig*, 236 N. Y. 100, 104; 140 N. E. 209 (1923) as to the involuntary nature of the payment of contested New York real estate taxes.

[3] Cf. *Commissioner* v. *Boylston Market Ass'n.*, 131 F. 2d 966 (1st Cir., 1942) (prepaid insurance); *Cooperstown Corporation* v. *Commissioner*, 144 F. 2d 693, 696 (3rd Cir., 1944), *cert. denied*, 323 U. S. 772 (payment of nonexistent tax liability).

[4] See *Commissioner* v. *Boylston Market Ass'n.*, *supra*, at p. 968.

By predicating its decision upon payment, the Court below introduced a wholly alien concept to the principles of accrual established in *Dixie Pine* and *Security Flour Mills,* and thereby substituted and prescribed "a divided and inconsistent method of accounting not properly to be denominated either a cash or an accrual system" (*Security Flour Mills,* 321 U. S. at p. 287).

(b) *Olympic Radio* held that the phrase "paid or accrued" as used in the various sections of the income tax law must be uniformly construed to mean "paid" by a cash basis taxpayer or "accrued" by an accrual basis taxpayer.

The Court below has in effect nullified this ruling by giving the term "accrued", as used in Section 23(c), a meaning which is contrary to the acknowledged principles of accrual. It engrafts upon the concept of accrual the criterion of payment—a criterion that is solely applicable to the cash method of accounting—and thereby accomplishes, indirectly, that which this Court held it may not do, directly.

(c) The *Lewyt* case followed the ruling in *Olympic Radio* and, in addition, stated that "the amount of tax accrued within the taxable year * * * is to be determined in accord with the normal accounting concepts relevant to the accrual basis" and that "when an amount is arrived at by proper application of recognized accounting principles on the accrual basis, the test of [the statute] has been met." (349 U. S. at pp. 242-243).

The Court below, however, refused to follow this principle, and held that the amount of local real estate taxes to be accrued and deducted under Section 23(c) is to be determined by the amount of cash paid even though such treatment was directly contrary to the recognized accounting principles on the accrual basis which the Court itself found to be applicable.

2. The extent to which accounting concepts determine the propriety of tax accruals for income tax purposes is a question of importance in the administration of the income tax laws.

The decision of the Court below strikes at basic principles of statutory construction important to the understanding and administration of the income tax laws. Section 41 of the 1939 Code (p. 15) provides for the computation of a taxpayer's net income "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer"; Section 43 (p. 16) provides that deductions shall be taken in the year paid or accrued "dependent upon the method of accounting upon the basis of which the net income is computed"; and Section 48 (p. 16) provides that "the terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed". These provisions, as well as that of Section 23(c), have been substantially reenacted in the Internal Revenue Code of 1954.

In addition to creating doubt in areas believed to have been definitively determined by this Court, the decision below seeks to create an unnecessary and unwarranted difference between income tax accrual and generally accepted principles of accrual accounting, thus reversing the long trend toward coordination between income tax and accounting principles.

From the very beginning this Court has sought to harmonize the two principles. In *United States* v. *Anderson*, 269 U. S. 422, 440 (1926), it was stated that Congress intended in the Revenue Acts "to enable taxpayers to keep their books and make their returns according to scientific accounting principles". And, as already noted (p. 8), only recently it was stated in *Lewyt* that "where an amount is arrived at by proper application of recognized accounting principles on the accrual basis the test of [the statute] has been met".

It is of paramount public interest that unnecessary differences between income tax and accounting principles be avoided wherever possible. Harmony between the two should be the rule and conflict between the two the exception. An artificial exception of judicial origin in respect of one type of deduction casts doubt and uncertainty upon all types of deduction.

The decision of the Court below creates such an artificial exception and, in addition to being contrary to the principles established by this Court, brings uncertainty to the construction of the income tax statute as to the accrual of all types of deductions. If payment could remove the non-accruable and non-deductible character of a contested tax liability it would follow that payment could remove those characteristics from other items which have been held to be non-deductible.[5] Taxpayers on the accrual basis —and "most corporations are on the accrual not the cash basis" (*Olympic Radio*, 349 U. S. at p. 236)—may not feel safe, under the decision of the Court below, in using scientific accounting principles to determine their income tax liabilities.

It is believed the decision of the Court below is contrary to the decisions of this Court above cited (pp. 6, 9) and of the Courts of Appeals for the First Circuit and the Third Circuit above cited (p. 7). If it is not, then the Court of Claims decided an important question of federal income tax law which has not been, but should be, settled by this Court.

3. The decision of the Court below is erroneous on its own facts and reasoning.

The Court below found (finding 44, p. 42) that, under accepted and well recognized principles of accounting, the proper entries with respect to the $100 were: in 1939, to charge $85 as tax expense and to set up an asset account

[5] See cases in note 3, p. 7.

of $15 as deposit for contested taxes; and in 1941, to charge $10 as tax expense and to record the receipt of $5 as a return of the remaining unapplied deposit for contested taxes. The Court disregarded these findings

> "because such [accounting] principles represent a refinement in ascertaining net income that would be impractical and, in our opinion, infeasible in the administration of the revenue laws". (p. 24).

There is no evidence of record or finding in this case of impracticality or infeasibility; nor does the Court below explain in what respects it would be impractical or infeasible.

On the contrary, it would appear to be impractical and infeasible *not* to follow the objective criteria of recognized accounting principles in administering the revenue laws. (1) It would encourage administrative officers to disregard established principles whenever it would be in the interest of the revenue to do so, and to justify such arbitrary action on the ground of impracticality or infeasibility in the administration of the revenue laws; (2) it would also create an arbitrary difference in income tax consequences between taxpayers residing in states which permit contest of local taxes before payment and taxpayers residing in states which require payment before contest; and (3) the novel rule established by the Court below would change the fixed standard of accrual under accounting principles to a shifting standard of accrual dependent upon the time the taxpayer chooses, for his own convenience and tax benefit, to pay the contested tax.

The decision below purports to follow that Court's earlier decision in *Chestnut Securities Co.* v. *United States,* 104 C. Cls. 489, 62 F. Supp. 574 (1945). That decision was predicated upon the theory that "it is hardly conceivable that a liability asserted against him [taxpayer], which he has discharged by payment, has not 'accrued' within the meaning of the tax laws and the terminology of accounting. Accrual, from the debtor's standpoint, precedes payment,

and does not survive it". (104 C. Cls. at pp. 494-495; 62 F. Supp. at p. 576). But the findings of the Court below as to the applicable accounting principles (findings 35 to 38 inclusive, pp. 38-39) directly contradict this theory. In fact, the Court itself recognized this and abandoned that theory when it stated "What we have said does not mean that the mere payment of an item accrues that item, * * *" (p. 24).

In justification of its conclusion, however, the Court went on to state "but rather we hold that payment of an item which is *otherwise accruable* in the taxable year accrues that item, even though payment is made under protest and even though litigation is started within the taxable year to obtain repayment". (emphasis supplied). Whether the phrase "otherwise accruable" means "otherwise accruable but for the payment", or "otherwise accruable but for the denial and contest of liability", it is apparent that the Court below either prejudged the question in issue and predicated its decision on a theory directly contrary to *Dixie Pine,* or attempted to carve out an unwarranted exception to *Dixie Pine.* See supra, pp. 6-10. In either event the decision of the Court below was not based on the aforementioned principle of *Chestnut Securities* that payment, without more, accrues a contested liability and that this is in accord with applicable principles of accrual accounting.

Another ground upon which the Court below sought to justify its conclusion was that the determination of the year in which expenses are incurred and accrue for tax purposes under the accrual method of accounting is to be made "from a practical, not a technical legal test. *Lucas* v. *American Code Co.,* 280 U. S. 445, 449" (p. 23). But in the *American Code* case this Court resorted to the practical test only because "no definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted". (280 U. S. 445, 449). It is submitted that the decisions of this Court in *Anderson, Dixie Pine, Security Flour Mills* and *Lewyt,* all of which deal with

the construction of the statutory "accrual" of taxes, have established a definite legal test of accrual which is controlling herein. Furthermore, the practical test applied in the *American Code* case, resulted in this Court ruling that where liability is contested, the loss is not sustained until the contest is actually terminated.

It is submitted that the very reasoning and findings of the Court below demonstrate its conclusion to be erroneous.

Conclusion

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

JAMES K. POLK,
Counsel for Petitioner.

Of Counsel:

ROBERT E. COULSON,
HAROLD F. NONEMAN.